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IN THE

Supreme Court of the United States

OCTOBER TERM 1949.

No. 261

FRANK M. COBB, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

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To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

The Petitioner prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Sixth Circuit entered in the above entitled cause on April 4, 1949 (R. 52), affirming a decision of the Tax Court of the United States denying to the Petitioner the right to deduct, under Section 23(a)(2), Internal Revenue Code, attorney's fees paid in connection with a dispute arising out of a gift tax liability.

JURISDICTION.

The judgment of the Court of Appeals was entered on April 4, 1949.

The time for filing a petition for a writ of certiorari was extended to August 15, 1949 by order of a Justice of this Court (28 U. S. C. Sec. 350) (R. 59).

The jurisdiction of this Court is invoked under 28 U. S. C. Sec. 1254(1) and Sec. 240, amended, of the Judicial Code (28 U. S. Code, Sec. 347(a)).

OPINIONS BELOW.

The Findings of Fact and Opinion of the Tax Court of the United States are reported at 10 T. C. 380 (R. 34-43).

The Opinion of the Court of Appeals is reported at 173 F. 2d 711.

QUESTION PRESENTED.

Are expenses of litigation arising from a contest of gift tax liability, on gifts of income producing property, incurred in the "management" of such property within the meaning of Sec. 23(a)(2) Internal Revenue Code? Under Sec. 23(a)(2) of the Internal Revenue Code, individuals may deduct from gross income those non-trade or non-business expenses incurred in the "management, conservation, or maintenance of property held for the production of income."

The Tax Court and the Court of Appeals answered the question "No." Petitioner contends the answer should be "Yes."

STATUTE INVOLVED.

Sec. 23 of Internal Revenue Code (26 U. S. C.) as amended by Sec. 121(a), Revenue Act of 1942, c. 619, 56 Stat. 798 (applicable to taxable years beginning after December 31, 1938), reads in part as follows:

"Sec. 23. *Deductions From Gross Income.*

"In computing net income there shall be allowed as deductions:

"(a) Expenses.—

* * * *

"(2) Non-Trade or Non-Business Expenses.—

"In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income."

STATEMENT.

The facts in this case are partly stipulated (R. 25, 26, 27), part appear in the Findings of Fact of the Tax Court, and the remainder appear in the undisputed testimony and exhibits (R. 15 to 25, inclusive). The Record, therefore, presents a clear-cut issue of law whether, upon such facts, Petitioner is entitled to the relief prayed for.

The taxable year involved is 1944. In that year Petitioner paid his attorneys $2,260.00 as fees for their advice and services in connection with the gift tax dispute with the Commissioner of Internal Revenue which occurred in the years 1942 and 1943 (Tax Court Findings of Fact, R. 36). Petitioner resides in Cleveland, Ohio, and filed his income tax return for 1944 with the Collector of the Eighteenth District of Ohio at Cleveland (R. 25, 35). Petitioner's books were kept and his 1944 return was made on a cash receipts and disbursements basis (R. 36).

Prior to December 1, 1941, Petitioner owned an undivided one-half interest in a certain parcel of real estate located at 234-236 Euclid Avenue, Cleveland, Ohio. On or about December 1, 1941, Petitioner delivered to each of his four daughters a deed of gift, transferring to each of them an undivided 1/12th interest in fee simple of such real estate (R. 16, 26, 35). The purpose of Petitioner in making said gifts was to aid his daughters and their families financially and to reduce his income taxes (R. 36).

In 1940 Petitioner's income from said property was $20,000.00, which in 1941 increased to $33,500.00 (R. 16). One-half interest in said property had an approximate value of $300,000.00, and in addition thereto Petitioner owned other income-producing real estate and securities of a value in excess of $200,000.00 (R. 15).

Petitioner filed a gift tax return for the year 1941 and paid therewith a gift tax of $18,943.65 (R. 26, 35). Before making such return Petitioner consulted John D. Fackler of the firm of Fackler, Dye and Hopkins, a lawyer experienced in real estate valuations, as to what value should be used in the return for each 1/12th interest (R. 17). These attorneys were at that time litigating an estate tax proceedings involving a valuation by the Commissioner of Internal Revenue of a 1/18th interest in the same property (R. 16, 17). On July 29, 1942, the Internal Revenue Agent in charge in Cleveland mailed Petitioner a letter proposing an adjustment of said gift tax liability, which resulted in a gift tax deficiency of $13,840.52 (R. 26). In this letter the valuation of each 1/12th interest in said property was increased 70 percent over the valuation returned by Petitioner (R. 17). About August 6, 1942, Petitioner consulted Fackler, Dye and Hopkins with respect to the proposed adjustment. These attorneys advised against acceptance of the same, and prepared and filed a protest on Petitioner's behalf (R. 26). On November 23, 1942, the Commissioner of Internal Revenue notified Petitioner that a determination of his gift tax liability for 1941 disclosed a deficiency of $13,840.52, upon an increase of 70 percent in the valuation of said 1/12th interests. At Petitioner's request the attorneys prepared and filed a petition for redetermination of such deficiency in the Tax Court of the United States (R. 26, 35). After Petitioner's attorneys had prepared for trial before the Tax Court, a settlement was reached, and pursuant to a stipulation of the parties, on December 14, 1943 the Tax Court found a deficiency in such gift tax in the amount of $6,000.00 (R.

35). On or about December 29, 1943, Petitioner paid such deficiency together with interest of $643.80 (R. 35). In order to pay said deficiency of $6,000.00, Petitioner sold income-producing securities at a loss (R. 36). If the original deficiency of $13,840.52 had been sustained, Petitioner would have had to sell additional income-producing property in order to pay the tax (R. 36). On January 12, 1944, Petitioner paid said attorneys $2,260.00 as fees for their advice and services in connection with said litigation, which amount was reasonable for the services rendered (R. 27).

The question here presented with respect to the taxable year 1944 arose upon an audit by the Commissioner of Internal Revenue and the assessment on September 9, 1946 of an income tax deficiency in the amount of $360.32 (R. 8, 25). Petitioner protested said deficiency, and on December 4, 1946 (R. 26), filed in the Tax Court of the United States a petition for redetermination of the deficiency and claimed a refund of $1,356.18 based upon a recomputation of the income. In computing such income, Petitioner claimed a deduction of $2,260.00 as attorney fees paid in 1944 for advice and services in contesting said Federal gift tax liability (R. 7). On April 15, 1948 the Tax Court, with three judges dissenting, sustained the Commissioner in part and fixed and determined the income tax deficiency in the sum of $203.67 (R. 44). The Tax Court approved the determination of the Commissioner in disallowing as a deductible item under Sec. 23(a)(2) the attorney fees paid by Petitioner in connection with said gift tax dispute (R. 34). On July 2, 1948, Petitioner filed in the United States Court of Appeals for the Sixth Circuit a petition to review the decision of the Tax Court (R. 44). On April 4, 1949, in Case No. 10759, the Court of Appeals affirmed the decision of the Tax Court (R. 52).

PETITIONER'S CLAIMS.

The Euclid Avenue property was income-producing property. Four 1/12ths were donated by Petitioner to his daughters, and 1/6th was retained by him (R. 15).

When Petitioner received the letter of the Agent of the Commissioner dated July 29, 1942, proposing a 70 percent increase in the value of each 1/12th interest and an increase in the gift tax from $18,943.65 to $32,784.17, he had the alternative of accepting the deficiency or in applying to the Tax Court for a redetermination of the same. After consultation with his attorneys, Petitioner directed them to take the necessary legal steps to protect and defend Petitioner and the property included in the gift.

The Federal gift tax (Secs. 1000 to 1031, Internal Revenue Code) is an excise upon the transfer of property by gift. Such tax is imposed on the exercise by the owner of his right to give away his property (*Bromley* v. *McCaughn*, 280 U. S. 124, November 25, 1929). The gift itself is the generating cause of the tax, and the gift tax liability attaches to the donor from the time of the gift (Sec. 1008, Internal Revenue Code). The law also imposes the lien on the donated property from the time the gift was made (Sec. 1009, Internal Revenue Code).

The settlement of the deficiency in the Tax Court at $6,000.00 saved Petitioner $7,840.52. It also extinguished the gift tax lien on the donated property. The decision of Petitioner to contest the deficiency was an act of "management" not only with respect to the donated property, but also with respect to the property retained by Petitioner. With respect to the latter, there was "conservation" of income producing property of the value of $7,840.52.

For the services of the attorneys in handling this dispute, Petitioner paid the sum of $2,260.00. Under the circumstances, this was "ordinary and necessary expenses" in the "management" of Petitioner's income-producing property. There is no dispute in the Record that the services of the attorneys were rendered in connection with the gift tax dispute. It is stipulated that the amount of the fees paid to them was reasonable (R. 27, 36). The

courts below denied the claimed deduction upon the erroneous view that denial was required as a matter of law (cf. *Commissioner of Internal Revenue* v. *Heininger*, 320 U. S. 467, 475).

Although upon the execution of the deed of gift the holding of the income-producing property of Petitioner reached its expiry, yet the making of the gift *per se* imposed upon Petitioner the duty of paying the gift tax. The proceedings with relation to the determination and payment of such tax required further action by Petitioner. These acts were separate and independent from the making of the gift and were the acts that directly brought about the hiring of the attorneys and the incurring of the litigation expenses here involved.

DECISIONS OF COURTS BELOW.

Both the Tax Court and the Court of Appeals disposed of this case on the ground that the giving away of property is not an act of "management" within the meaning of Sec. 23(a)(2). (Opinion of Tax Court, R. 34-43; Opinion of Court of Appeals, R. 52.)

The Court of Appeals could find no warrant under Sec. 23(a)(2) for allowing the deduction claimed by the Petitioner for the following reasons:

(1) The Treasury Regulations 111, Sec. 29.23(a)-15(b) as amended (May 14, 1946) by T. D. 5513, explicitly prohibited deduction of the gift tax expenses in this case.

(2) The only act of "management" found by the court was the act of "making the gifts." The various acts of Petitioner in discharging his duty to pay the gift tax are not mentioned in the opinion of the court. The court stated: "We are unable to adopt the impractical concept that giving away property produces income to the donor, or constitutes either management or conservation of the property."

(3) In undertaking to distinguish the case at bar from *Bingham* v. *Commissioner of Internal Revenue*, 325 U. S. 365, the court said:

> "In the *Bingham* case, the trustee was bound to the duty of managing and distributing the trust property. Here, the taxpayer made voluntary personal gifts of a part of his own property to his daughters. These gifts were not distributions which he was compelled to make. Nor were they essential to the 'management, conservation, or maintenance of property held for the production of income.' Certainly, the expense appertaining to making the gifts does not fall within the category of 'ordinary and necessary paid or incurred during the taxable year for the production or collection of income.' "

REASONS FOR GRANTING THE WRIT.

(1) The question whether attorney fees incurred in contesting a gift tax liability are deductible under Sec. 23(a)(2) is an important question of Federal law which has not been, but should be, settled by this court.

This section was enacted by Congress in 1942 for the benefit of individual taxpayer who were, under Sec. 23(a)(1), denied the right to deduct expenses incurred in the management of income-producing property (*Higgins* v. *Commissioner*, 312 U. S. 212). The only decision of this court interpreting that part of Sec. 23(a)(2) pertaining to the deduction of expenses and attorney fees incurred in the "management" of income-producing property is *Trust of Bingham* v. *Commissioner*, 325 U. S. 365 (decided June 4, 1945).[1]

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[1] Section 23(a)(2) affects nearly every individual taxpayer. The frequency with which lower courts have cited the *Bingham* decision indicates that it has not settled the interpretation of Section 23(a)(2) for the Commissioner, the taxpayers, or the lower courts. The Prentice-Hall Tax Citator shows that the part of the *Bingham* opinion dealing with Section 23(a)(2) has been cited in 32 separate cases, including citation in 7 dissenting opinions; that it has been "explained" in three United States Court of Appeals opinions and has been "distinguished" in two United States Court of Appeals opinions.

In the case at bar the question arises under an *inter vivos* gift. In view of the great number of taxable gifts being currently made by individuals, this question is of great importance and should be decided now.[2]

(2) The decision of the Court of Appeals in the case at bar is in conflict in principle with the authoritative interpretation of Sec. 23(a)(2) by this court in the *Bingham* case. The statute was fully considered by this court and principles were announced which are controlling in the case at bar. This court held that the expenses and attorney fees incurred by testamentary trustees in winding up the trust after its expiration were deductible under Sec. 23(a)(2) as expenses of "management" (Syllabus 2, pp. 373, 376). The ruling is distinctly and repeatedly made that the trust property did not cease to be "held for the production of income," even when the trust reached its "expiry" date and the trustees were engaged in distributing the same to the beneficiaries (Syllabus 3, pp. 373, 374, 375). The important principles of interpretation laid down by this court were that property "held for the production of income" does not cease to be such during the process of distribution to the new owners and that such distribution is a function of "management".

With respect to these points this court said (pp. 374, 375):

> "The Government contends that the expenses incurred in connection with the distribution of the corpus of the trust to legatees are not deductible, because they are not expenses of managing income producing property, but expenses in connection with the devolution of the property. If the suggestion is correct, it would follow that expenses incurred in distributing the income of the trust to the income beneficiaries are likewise not deductible, since the distribution of income is also a dev-

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[2] The reports of the Commissioner of Internal Revenue show that a total of 224,252 gift tax returns were filed during the past ten years. For the fiscal year 1948, 30,603 returns were filed and $9,861,586.00 in additional gift tax assessments were made by the Commissioner. (Annual Report of Commissioner of Internal Revenue, 1948, page 39.)

> olution of trust property. But the duties of the trustees were not only to hold the property for the production of income and to collect the income, but also, in administering the trust, to distribute the income and the principal so held from time to time, and the remainder of the principal at the expiration of the trust. Performance of each of these duties is an integral part of carrying out the trust enterprise. Accordingly, as the Tax Court held, the costs of distribution here were quite as much expenses of a function of 'management' of the trust property as were expenses incurred in producing the trust income; and if 'ordinary and necessary', they were deductible."

In the case at bar Petitioner's income-producing property passed to the donees under the deed of gift, subject to the payment of the gift tax by the donor. The law imposed upon the donor the duty to pay the tax, and subjected the donated property to a lien until the tax was paid. The various steps taken by Petitioner in paying the tax and freeing the donated property from the lien were acts of "management" in the "devolution" of said property. Consequently, the attorney fee expense incurred in such proceedings constituted a deductible item under the statute.

(3) The Regulations of the Treasury Department 111, Sec. 29.23(a)-15(b), T. D. 5513, approved May 14, 1946, definitely disallow the deduction of expenses in contesting a gift tax liability. These Regulations are in conflict with the principles announced by this court in the *Bingham* case. Many people owning income-producing property are currently making taxable gifts. Such taxpayers should not be confronted with invalid regulations of the Treasury Department and erroneous decisions of the lower courts which will deter them from making gifts or in asserting their right to contest a gift tax deficiency. If such regulations and decisions are wrong, they should not be permitted to stand as a controlling declaration and interpretation of the law.

(4) The Court of Appeals denied the claimed deduction upon an erroneous view of the law. Said court ignored

the important teaching of the *Bingham* case that within the meaning of Sec. 23(a)(2), I. R. C., property does not cease to be "held", even though the period of such holding draws to its "expiry" date and such property is being distributed to its new owners. Said court further undertook to distinguish the *Bingham* case on the ground that the trustee in that case had a "duty" to perform at the "expiry" date of the testamentary trust, that is, the distribution of the trust res to the beneficiaries. They failed to understand and to give effect in the case at bar that Petitioner had a "duty" to perform with respect to the donated property, i.e., the discharge of his gift tax liability, and the resultant cancellation of the gift tax lien on the donated property.

Said court decided this case on the assumption that the only act of "management" by Petitioner was "giving away property." No heed was given to the acts of Petitioner in contesting the gift tax deficiency assessed by the Commissioner of Internal Revenue. Said court apparently failed to understand the meaning, force and effect of the Federal gift tax law, i.e., that the making of the gift, *per se*, imposed a personal obligation on the donor to pay the tax and a lien on the donated property to assure such payment. Clearly, the contesting of such deficiency was a separate and independent act of "management" from that of making the gift. Furthermore, it was the act that proximately occasioned the attorney fee expense—the deduction claimed in this case.

CONCLUSION.

This Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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